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LETTER LORD VIS. MELBOURNE - TORRENS

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**A LETTER**

**TO THE**

**RIGHT HON. LORD VISCOUNT MELBOURNE.**

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# A LETTER

TO

THE RIGHT HONOURABLE

LORD VISCOUNT MELBOURNE,

ON THE

CAUSES OF THE RECENT DERANGEMENT

IN

THE MONEY MARKET,

AND ON

BANK REFORM.

BY

R. TORRENS, Esq., F.R.S.

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# LETTER

TO THE

RIGHT HONOURABLE

LORD VISCOUNT MELBOURNE.

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MY LORD,

IN the approaching session of Parliament, our banking system, and its influence upon commercial credit, will demand the early attention of the Legislature. Without occupying your Lordship's time with any preliminary observations, I request permission to offer the following considerations upon these very important subjects.

In order to obtain an accurate knowledge of the causes which have produced the recent disturbance in the money market, it is necessary that we should have a distinct perception of the several component parts of which our money actually consists. Now, it will be found, that in consequence of the system of banking which prevails in this



country, our money is composed of two distinct and different elements, namely, of circulating money, and of credit money ; the circulating money consisting of the coin and bank notes actually in circulation ; the credit money consisting of the deposits placed in the hands of bankers, and of the cash credits granted by them.

The manner in which that portion of the medium of exchange, which consists of coin and of bank notes, acts upon prices, and, through prices, upon the foreign exchanges, is sufficiently apparent, and needs no explanation. But neither the members of the Government, nor the directors of the Bank of England, appear to be aware of the extensive influence which is exerted upon prices, and, through prices, upon the foreign exchanges, by that portion of the medium of exchange which consists of deposits and cash credits. This *terra incognita* of our monetary system it therefore becomes necessary to explore.

*Bank Deposits perform the functions of Money.*

When a merchant opens an account with a solvent bank, by depositing cash to the amount of 1000*l.*, he has exactly the same command

of money, exactly the same power of making payments, and of making purchases, which he would have possessed had he kept cash to the amount of 1000*l.* in his own desk. It is evident, therefore, that the 1000*l.* thus deposited are not withdrawn from circulation, and do not cease to form a part of the medium of exchange by being transferred from the desk of the merchant to the coffer of the bank. To a merchant who has, in a solvent bank, a deposit against which he can draw his checks, that deposit is *money*. But the case of an individual merchant having a deposit with a bank, is the case of all other persons who keep their cash with bankers. It is evident, therefore, that all the deposits in all the solvent banks throughout the country perform the functions of money, form a part of the medium of exchange, and act upon prices, and upon the foreign exchanges, exactly in the same way, and to the same extent, in which the same amount in coin and bank notes would act upon prices and upon the foreign exchanges.

As deposits made with banks perform all the functions of money, it is necessary to consider in what way, and to what extent, the practice, now become so general, of keeping cash with bankers, increases the power of

the medium of exchange. This is a question which the directors of the Bank of England appear never to have attended to. Nevertheless, it is one of the greatest importance ; and I therefore solicit your Lordship's indulgence, while I endeavour to arrive at a correct solution of it.

When merchants and others transfer coin and bank notes from their own desks to the hands of their bankers, the operation would not have the effect of contracting the currency, even though the bankers should keep the whole of the coin and notes transferred to their custody, locked up in their coffers until drawn out by the depositors. The following illustration will make this apparent.

Let us assume that the merchants and dealers within the metropolitan district, require, for the conducting of their business, circulating money to the amount of 10,000,000*l.*, and that they actually hold this amount in coin and Bank of England paper. This being the previous state of things, let us assume again, that these merchants and dealers open accounts with the London bankers, and place with them, as deposits, the 10,000,000*l.*, in coin and notes, which they before kept in their own desks. Now this change in the manner of keeping the



cash required to meet the current demands of the market, would not leave the merchant and dealer with a less command of money, with a less power of making payments and of making purchases, than they before possessed. By drawing checks upon their bankers to the amount of 10,000,000*l.*, they can come into the market just as effectually as they could before have done by bringing out coin and notes to that amount from their own cash boxes. If the whole of the 10,000,000*l.* in coin and notes, deposited with the bankers, were locked up in their coffers until drawn out in payment of the checks of the depositors, this locking up of coin and notes would have no conceivable effect in depriving the depositors of the power of drawing checks, and of making payments or purchases to the amount of the 10,000,000*l.* It is evident, therefore, that transferring coin and bank paper from the desks of merchants and others, and placing them for safe custody as bank deposits, could have no effect whatever, either in contracting or in expanding the currency, *even if the whole of the coin and bank paper so transferred were locked up in the coffers of the bank, until withdrawn in payment of the checks of the depositors.* But the whole of the coin and notes deposited

with the banks would not be locked up until required in payment of the checks drawn by the depositors. Bankers make their profit by lending, upon available securities, the greater part of the sums deposited with them by their customers. When our merchants and dealers deposited 10,000,000*l.* with the banks, the bankers would retain a part of the sum—say 2,000,000*l.* as a reserve, or rest, for the purpose of making occasional payments over their counters, and would employ the other 8,000,000*l.* in the purchase of stock, or of exchequer bills, or in the discount of bills of exchange. Now, it is self-evident that this would occasion an extension of the general medium of exchange. The merchants and others, who had deposits with the bankers to the amount of 10,000,000*l.*, would be just as able as they were before to come into the market, and make payments and purchases to the amount of 10,000,000*l.* ; while the persons who sold the stock, and the exchequer bills, or who obtained the discounts, would be able to come into the market, and effect payments, and make purchases, to the amount of 8,000,000*l.* Thus, in this case, which has been taken for illustration, the operation of the private banks in receiving deposits, and in investing

them in available securities, would have the effect of increasing the circulating medium by 8,000,000*l*.

By the foregoing illustrations, two important principles have, as I believe, been established. *1st.*—That deposits with solvent banks form a component part of the general medium of exchange, and perform the functions of money just as effectually as the coin and bank notes actually in circulation. *2nd.*—That the practice of merchants and others, in keeping their cash with bankers, and the practice of bankers in employing the cash thus placed in their hands, have the effect of increasing the general medium of exchange, by the amount of that portion of the cash of their customers, which bankers may find it prudent to employ. These principles being established, it will be necessary, in order to obtain a distinct and complete view of the effect produced upon the currency, by the system of banking which prevails in this country, to consider the circumstances which determine the proportion between the amount of deposits standing in the books of bankers, and the amount of the coin and bank notes which they employ in meeting occasional demands.

In periods of confidence and high commercial credit, a small amount in coin and

bank notes, may serve as the basis of a large amount of bank deposits. It follows, that in such periods, the circulating medium may expand, without any increase in the amount, either of coin or of bank notes; and that, while the amount of coin and notes remains undiminished, the circulating medium may suffer contraction. The expansion and contraction of the currency, resulting from an increase or diminution of bank deposits, is a subject of the greatest practical importance; and as it is a subject which appears to have been overlooked by every writer upon the science of money, with the single exception of Mr. Pennington, I am under the necessity of again soliciting your Lordship's attention, while I endeavour to explain it.

*A given amount of circulating Cash becomes the basis of a much greater amount of Bank Deposits.*

In order to place the effect of bank deposits in enlarging the medium of exchange, in a clear and distinct point of view, let us assume that there are no bank notes employed in the district of the metropolis, and that, in this district, the coin retained in circulation amounts to 15,000,000*l.*, of which, 5,000,000*l.* are in the hands of

persons who do not employ bankers, and 10,000,000*l.* belong to merchants and others, who do employ bankers. In this case, if the bankers kept the whole of their deposits of 10,000,000*l.* locked up in their coffers, the currency of the metropolis would still amount to 15,000,000*l.*; and would consist of 5,000,000*l.* of coin, circulating amongst those who did not keep their cash with bankers, and of 10,000,000*l.* of deposits, belonging to merchants and others, who did employ bankers. But it is quite certain, that the bankers would not keep the whole of the 10,000,000*l.* deposited with them, locked up in their coffers. They would re-issue the greater part of the sum, say 8,000,000*l.*, in the discount of mercantile bills, or in the purchase of government securities; and therefore the money of the metropolis, instead of being, as before, 15,000,000*l.*, would be 25,000,000*l.* *viz.*

<i>£.</i>	
Coin in the hands of persons not keeping cash with bankers .....	5,000,000
Deposits placed to the credits of persons employing bankers .....	10,000,000
Coin issued by the banks upon securities .....	8,000,000
Coin resting in the banks .....	2,000,000
	<hr/>
	<i>£</i> 25,000,000
	<hr/>



Under the circumstances which have been assumed for the sake of illustration, the persons not employing bankers, and requiring, for their purchases and payments, money to the amount of 5,000,000*l.*, are already in possession of that sum; and this being the case, the 8,000,000*l.* which the bankers took from their deposits, and issued upon securities, would be immediately returned upon them, in the form of new deposits. Taken collectively, the liabilities and assets of the banks would now stand thus :—

	<i>Deposits.</i> <i>£.</i>	<i>Coin.</i> <i>£.</i>	<i>Securities.</i> <i>£.</i>
Liabilities ...	18,000,000		
Assets .....		10,000,000	8,000,000

The 10,000,000*l.* which the banks would now again possess, would be found more than sufficient to meet the occasional demands of the customers, who owned the 18,000,000*l.* of deposits; the bankers would feel themselves fully justified in employing a considerable portion, say 6,000,000*l.* out of 10,000,000*l.* upon securities, and in retaining a rest of only 4,000,000*l.* to meet occasional demands.

Now, as the persons who do not keep cash with bankers, already have the 5,000,000*l.* of currency, which is sufficient for their

transactions, the whole of this second re-issue of coin by the banks would be again returned to them in the form of new deposits. Therefore, the aggregate account of the liabilities and assets of the bankers would now be as follows :—

	<i>Deposits.</i> £.	<i>Coin.</i> £.	<i>Securities.</i> £.
Liabilities ...	24,000,000	10,000,000	14,000,000
Assets .....			

The bankers would still find that a reserve or rest of 10,000,000*l.* in coin would be more than sufficient to meet the occasional demands of the customers who had credit on their books for the 24,000,000*l.* of deposits. A part of this coin would be again advanced upon securities, and would be again returned upon the banks, in the form of new deposits, restoring their reserve or rest to the original sum of 10,000,000*l.* The *modus operandi* is sufficiently obvious. Whatever may be the amount of the circulating money, one portion of it will be in the hands of those who do not keep their cash with bankers; while the remaining portion will be in the hands of those who do keep their cash with bankers. Now, if that portion of the circulating money which is at the command of those who keep their cash with bankers, amounts to 10,000,000*l.*, the bankers, at the close of each day's business, will have 10,000,000*l.* in

their coffers. Whatever sums they may advance upon securities in the morning, the same sums will be returned to them in the evening, in the form of new deposits; and in this way the amount of their deposits must continue to increase, until they bear that proportion to the fixed amount of the returning cash, which the experience of the bankers may suggest as safe and legitimate. In the case which I have taken for illustration, the bankers of the metropolis have coin constantly returned to them to the amount of 10,000,000*l.*; and should they consider it safe to re-issue this returning coin upon securities, until their liabilities bore to their cash the proportion of ten to one, then their aggregate account would stand thus:—

	<i>Deposits.</i> <i>£.</i>	<i>Coin.</i> <i>£.</i>	<i>Securities.</i> <i>£.</i>
Liabilities ...	100,000,000		
Assets .....		10,000,000	90,000,000

But should the bankers deem it unsafe to let the amount of their liabilities exceed that of their returning cash, by a greater proportion than five to one, then the aggregate account of their liabilities, cash, and securities, would be as follows:—

	<i>Deposits.</i> <i>£.</i>	<i>Coin.</i> <i>£.</i>	<i>Securities.</i> <i>£.</i>
Liabilities ...	50,000,000		
Assets .....		10,000,000	40,000,000

Thus we see that, in consequence of the system of banking prevalent in this country, a fixed amount of circulating money may be the basis of a fluctuating amount of credit money, even though the circulating money should be purely metallic. It would be difficult to say in how great a proportion, during periods of high commercial confidence, the amount of credit money might exceed the amount of the circulating money on which it is based; and we can imagine extreme cases of general panic, in which the superstructure of credit money might almost entirely disappear. The medium of exchange in this country is a complicated and delicate machine, requiring, for its due regulation, the strictest application of scientific principles.

No accounts are published, showing the proportion which the deposits made with private bankers, bear to the cash which such bankers hold, for meeting occasional demands; this proportion will necessarily vary with the variations of commercial confidence. When trade is prosperous, when few failures are occurring, and when commercial bills are promptly paid as they fall due, bankers might consider it safe to continue to re-issue, upon securities, the cash returning upon them as deposits, until the proportion between their

deposits and their cash, became as fifteen to one, or even as twenty to one. In periods of commercial pressure, on the other hand, bankers would be disposed to contract their liabilities, until the deposits which they might be called upon to pay on demand, bore to their cash a proportion, not exceeding seven to one, or even five to one. We have, however, no precise data enabling us to ascertain, at any particular period, the proportion which private bankers maintain, between their deposits and their cash. Mr. Clay, whose practical and scientific knowledge of the money market, renders him a high authority upon such subjects, stated, in the House of Commons, when moving for the appointment of the Select Committee upon Joint-Stock Banks, that, in ordinary times, one tenth, or even one twentieth, of the money deposited with a banker, is a sufficient rest for meeting occasional demands; and that nine-tenths, or even nineteen-twentieths, of the sums deposited with a bank, may be lent out on securities, bearing interest. This is sufficient proof that I should not be arguing on an extreme case, were I to assume that the cash originally deposited by those who keep their accounts with bankers, will be successively re-issued upon securities, by the banks, and

successively returned to them, in the form of new deposits, until the proportion between the amount of the deposits, and the amount of the cash, is as ten to one. But though it might be justifiable, yet it is unnecessary, to resort to a case so strong. The charge of mis-management which I have to prefer against the bank directors, will be sufficiently made out, if we take the proportion as low as five to one.

*Effect of the Foreign Exchanges upon a  
Currency consisting of Circulation and  
Deposits.*

It will now be necessary, before I proceed to state and establish the charge of mis-management, to examine the effect of the foreign exchanges, in contracting and expanding a currency consisting of coin, and of bank deposits. Let us assume, as before, that the reserve, or rest, in the hands of the bankers of the metropolis, amounts to 10,000,000*l.* in coin; that the proportion which they usually preserve between their deposits and their reserve of cash, is as five to one; and that, therefore, the whole amount of the money, including cash and deposits, at the command of the bankers, and of their



customers, amounts to 60,000,000*l.* This being the previous state of things, let us suppose that the exchanges become adverse, and that the merchants withdraw from the banks 1,000,000*l.* of gold for exportation. By this withdrawal and exportation of specie, the reserve of cash in the hands of the bankers will be reduced from 10,000,000*l.* to 9,000,000*l.* ; and the bankers, in order to protect themselves, will find it necessary to reduce their liabilities, in a similar proportion. Assuming that five to one is considered as the proper proportion to be maintained between the amount of deposits and the amount of rests, then the bankers, in the case just stated, would proceed to reduce their deposits from 50,000,000*l.* to 40,000,000*l.* This they would be able speedily to effect. As cash came in, in payment of the bills they had discounted, they would not re-issue it upon new discounts, and therefore could not receive it back in the form of new deposits ; they would abstain from discounting, until their advances to their customers were reduced from 50,000,000*l.* to 40,000,000*l.* ; and until, by a necessary consequence, the cash which their customers could command and deposit, was reduced by a similar amount. A favourable exchange would produce op-

posite results. Should the influx of gold increase the cash in the hands of the bankers from 10,000,000*l.* to 12,000,000*l.*, the bankers would discount more freely, and the cash successively advanced in discount, would successively return in the form of new deposits; and thus the increase of the reserves or rests in the hands of the bankers from 10,000,000*l.* to 12,000,000*l.* would be speedily followed by an increase of the sums paid in to them as deposits from 50,000,000*l.* to 60,000,000*l.*

And now the ground has been sufficiently cleared, to enable us to trace the manner in which the directors of the Bank of England have mismanaged the currency.

*The Directors of the Bank of England have departed from the sound principle of leaving the Currency to expand and contract under the action of the Foreign Exchanges.*

The directors of the Bank of England profess to act upon the principle of regulating their issues so as to allow the currency to expand and contract, as the foreign exchanges become favourable or adverse. It is unquestionable that this is a sound principle; and that, were it acted upon, the currency would always be maintained in the same state, with



respect both to amount and to value, in which it would exist were the circulation composed exclusively of the precious metals. If the circulation were purely metallic, and consisted of 30,000,000*l.* of sovereigns, a favourable exchange, causing an importation of gold to the amount of 2,000,000*l.*, would increase the circulation from 30,000,000*l.* to 32,000,000*l.*; while an adverse exchange, causing an exportation of gold to the amount of 2,000,000*l.* would contract the circulation from 30,000,000*l.* to 28,000,000*l.* In like manner, if the circulation consisted of 30,000,000*l.*, in bank notes, and if the principle of allowing the circulation to expand and contract under the influence of the foreign exchanges were acted upon, a favourable exchange, causing an importation of gold to the amount of 2,000,000*l.* would cause bullion to the amount of 2,000,000*l.* to be poured into the Bank in exchange for notes, and would thus increase the circulation from 30,000,000*l.*, to 32,000,000*l.*; while on the other hand, an adverse exchange, causing an exportation of gold to the amount of 2,000,000*l.* would cause Bank notes to the amount of 2,000,000*l.* to be returned upon the Bank in exchange for the gold required for exportation, and would thereby reduce the circulation from 30,000,000*l.* to 28,000,000*l.*, as certainly

as if the circulation had consisted exclusively of gold.

Thus it is strictly demonstrable, that if the directors of the Bank of England acted upon the principle by which they profess to be guided, of allowing the currency to expand and contract under the action of the foreign exchanges, the circulating medium would be maintained in the same state, both with respect to volume and to value, in which it would exist were there no Bank notes in existence, and were the current money exclusively metallic. Now the charge which I bring against the directors of the Bank of England is, that instead of conforming to the sound principle by which they profess to be guided, they act in systematic violation of it. The proofs of this grave charge are exhibited in the accounts published under the authority of Parliament. These accounts, therefore, I proceed to examine.

The following table, showing the liabilities and the assets of the Bank of England, from December 1833, to June 1836, is printed in the Report of the Select Committee of the House of Commons, on Joint-Stock Banks, &c.

	Bullion.	Securiti
	£.	£.
respect both		
which it		
composed of	10,200,000	24,567,
If the circulation	8,753,000	25,787,
consisted of	8,885,000	27,471,
favourable ex	6,917,000	26,915,
gold to the	6,978,000	25,551,
crease the	6,295,000	24,533,
32,000,000%	6,613,000	25,221,
ing an exp	6,284,000	27,724,
2,000,000%	7,718,000	31,764,
30,000,000%	8,014,000	25,521,
	6,868,000	28,847,

This table will convince me the correctness of my Bank directors act in the principle of leaving the influence to contract and expand under changes. In December 1833, the circulation was 17,469,000%, and in March 1834, it was reduced to 8,753,000%; and the principle of leaving to contract under the action of the market, their circulation would be reduced to 16,022,000%. But in utter disregard of the principle upon which a paper currency is regulated, the Bank directors were thus flowing from the principle and increased their circulation to

18,544,000*l.*; and thus threw upon the money market an excess of circulating money to the amount of 2,522,000*l.*

In March 1835, the treasure in the coffers of the Bank was reduced from 10,200,000*l.*, its amount in December 1833, to 6,295,000*l.*; and if the directors, during this continued adverse exchange, had allowed their issues to contract as their gold was withdrawn, their circulation would have been reduced from 17,469,000*l.*, its amount in December 1833, to 13,564,000*l.* Yet, incredible as the fact may appear (and utterly incredible it would be, if not established by authentic official returns), the directors kept out a circulation of 18,152,000*l.*, and thus created in the money market an excess of paper to the amount of 4,588,000*l.*

The continuance of the adverse exchange, was the necessary result of this excess in the circulation. The Gazette account of the quarterly averages of liabilities and assets of the Bank of England, from the 23rd of August to the 15th of November, 1836, gives the following results:—

<i>Liabilities.</i>		<i>Assets.</i>	
Circulation ...	£.17,543,000	Securities ...	£.28,134,000
Deposits .....	12,682,000	Bullion .....	4,933,000
	<hr/>		<hr/>
	£.30,225,000		£.33,067,000
	<hr/>		<hr/>

Taking these figures as they stand, wi

troubling ourselves to inquire how much the actual quantity of bullion, held by the Bank during the last week of the quarter, fell short of the average of the whole quarter (which is all the return gives), we shall still have sufficient data to show the monstrous extent to which principle has been departed from in the regulation, or rather, in the no regulation, of the currency. Between December 1833, and November 1836, the treasure in the coffers of the Bank was reduced from 10,200,000*l.* to 4,933,000*l.*; while the issues of the Bank of England paper were increased from 17,469,000*l.* to 17,543,000*l.* ! How did the directors contrive to get out more paper while the adverse exchange was depriving them of gold ? Simply by violating the principle by which they profess to be guided. While the adverse exchange was reducing their treasure from 10,200,000*l.* to 4,933,000*l.*; and while, on every sound principle, they should have allowed their paper in circulation to contract from 17,469,000*l.* to 12,202,000*l.*, they increased their securities from 24,567,000*l.*, their amount in December 1833, to 28,134,000*l.*, their average amount for the quarter ending the 15th of November, 1836; and by issuing paper on the increased amount of securities, succeeded in causing the currency to expand,

under the action of a decided and protracted adverse exchange.

*The Bank Directors have failed to distinguish between the different effects produced upon the medium of Exchange by a contraction of their Issues, and by a contraction of their Deposits.*

It may be objected to the view which I have here taken of the conduct of the Bank, that its liabilities consist of its circulation, and of its deposits; and that the practical rule adopted by the directors, is, not to allow their circulation to contract and expand under the action of the foreign exchanges, but to keep their securities even, and to allow their whole liabilities, including circulation and deposits, to contract and expand under the influences of the exchanges. Now it certainly does appear, from the published accounts, that when the circulation of the Bank has been increased, their deposits have generally been diminished by an approximating amount; and it is therefore only fair to infer, that the practical rule adopted by the directors, is to keep their securities even, and to allow, not their circulation, but their whole liabilities, including both circulation and deposits, to expand or

contract under the action of the foreign exchange. But this is no answer to the grave charge of mismanagement, which I prefer against the Bank directors; because the adoption of such a rule is contrary to the principle\* of leaving the currency to expand or contract under the action of the foreign exchange, and is, in itself, as decisive a proof of mismanagement, and of departure from principle, as it is possible to conceive. The currency, or general medium of exchange, is composed of two distinct and different elements, namely:—of the circulating money, consisting of coin and Bank notes, and of the credit money, consisting of all those deposits and credits which stand in the books of bankers, and which are available in effecting purchases and payments. Now if these two elements were constantly equivalent, if the amount of the circulating currency were always equal to that of the credit currency, then it would be a matter of indifference, whether the Bank directors allowed the foreign exchanges to act upon their circulation, or to act upon their deposits. But, as has already been demonstrated, a given amount of circulating currency becomes the basis of a far greater amount of credit cur-

\* See Note at the end.

rency. Therefore, the Bank directors, in allowing the foreign exchanges to act, not upon their circulation, but upon their deposits, exhibit a lamentable ignorance of the principles upon which the issue of Bank paper ought to be regulated.

It is universally admitted, by persons acquainted with monetary science, that paper money should be so regulated as to keep the medium of exchange, of which it may form a part, in the same state, with respect to amount and to value, in which the medium of exchange would exist, were the circulating portion of it purely metallic. Now, it is self-evident, that if the circulating currency were purely metallic, an adverse exchange, causing an exportation of the metals to any given amount, would occasion a contraction of the circulating currency to the same amount ; and that a favourable exchange, causing an importation of the metals to any given amount, would cause an expansion of the circulating currency to the same amount. Therefore, when the directors of the Bank of England allow, not their circulation, but their deposits, to contract and expand under the influence of the foreign exchanges, they depart from the only sound principle upon which paper money can be regulated. If the circulating currency of the metropolis consisted of gold, an adverse exchange, causing an export-



ation of gold to the amount of £1,000,000 would withdraw from circulation one million of sovereigns; and therefore, as the circulating currency of the metropolis consists of Bank of England notes, an adverse exchange, causing one million in bullion to be withdrawn from the Bank, would require to have 1,000,000% of Bank notes withdrawn from circulation. As often as an adverse exchange abstracts any given amount of treasure from the Bank, without a withdrawal to the same amount of Bank of England notes from circulation, so often do the directors of the Bank of England exhibit a practical proof of their incompetency to perform the important function of regulating our monetary system. To say that their rule is to keep their securities even, and to allow the exchanges to act upon their whole liabilities, is not a defence, it is an admission that they do not understand their business.

In order to obtain a correct view of the extent to which the mismanagement of the affairs of the Bank of England has been carried, it will be necessary to state, in figures, the difference between the effects produced by a contraction of the circulation of the Bank, and those produced by a diminution of its deposits. I have already shown, that under the existing system of London banking, a given amount of circulating currency forms

the basis of a much larger amount of credit currency. On the principle stated by Mr. Clay, that, in ordinary times, bankers may employ upon securities nine-tenths, or even nineteen-twentieths of the sums deposited with them, a circulating currency, consisting of Bank notes to the amount of 1,000,000*l.*, may be the basis of a credit currency, consisting of deposits to the amount of 10,000,000*l.*, or even to the amount of 20,000,000*l.* I do not, however, avail myself of the very competent authority of Mr. Clay for the purpose of giving a highly coloured picture of Bank of England mismanagement. I take as the datum of my reasonings the moderate supposition that bankers employ, upon securities, only four fifths of the sums deposited by their customers ; and that, consequently, a circulating currency, consisting of 1,000,000*l.* of Bank notes, forms the basis of a credit currency of 5,000,000*l.*

When the treasure in the coffers of the Bank, decreased from 10,200,000*l.*, its amount in December 1833, to 8,753,000*l.*, its amount in March 1834, the diminution of treasure to the amount of 1,447,000*l.* should have been accompanied by a withdrawal of Bank of England notes from circulation to the amount of 1,447,000*l.* Had this been done, the aggregate amount of circulating cash returning

upon the private banks of deposit at the close of each day's business, would have been reduced by 1,447,000*l.*; and therefore these banks, supposing that they acted upon the principle of not allowing the amount of their liabilities to exceed the amount of their daily returning reserve of cash by a greater proportion than that of 5 to 1, would have reduced their advances upon securities, until the sums advanced, and again returned to them in the form of deposits, had been reduced by an amount five times greater than the amount of the Bank of England notes withdrawn from circulation. Hence, while the amount of the circulating currency was reduced by 1,447,000*l.*, the amount of the credit currency would have been reduced by 7,235,000*l.*; and the total reduction in the general medium of exchange, which acts upon prices and on the foreign exchanges, would have been 8,682,000*l.* But the directors of the Bank of England, instead of withdrawing 1,447,000*l.* Bank notes from circulation, as treasure to that amount was abstracted from their coffers, increased their circulation by 1,075,000*l.* and (bankers preserving the proportion of 5 to 1 between their cash and their liabilities) this extension of the circulating currency would have occasioned an extension of the credit currency to the amount of 5,375,000*l.*, being an en-

largement of the general medium of exchange to the amount of 6,450,000*l.* But from this we have to deduct 1,410,000*l.*, for the reduction in the amount of the deposits of the Bank of England from December 1833 to March 1834; and therefore the aggregate increase in the general medium of exchange effected by the operations of the Bank of England between December 1833 and March 1834, was 5,040,000*l.*

From the analysis now given of the accounts of the Bank of England, published by order of the House of Commons, the charges against the directors amount to this. By departing from the only sound principle upon which paper money can be regulated, they occasioned, between December 1833 and March 1834, an undue extension of the medium of exchange, which, at a moderate estimation, may be taken at 13,600,000*l.* Had they allowed the adverse exchange to contract their paper circulation, to the same extent to which it would have contracted a metallic circulation, the circulating currency would have been reduced by the actual amount of 1,447,000*l.*; while the credit currency would have been reduced by the probable amount of 7,235,000*l.* But, disregarding this legitimate rule, and allowing the adverse exchange to act upon their deposits instead of upon their circulation, the B

directors increased the circulating currency to the actual amount of 1,075,000*l.*; and the credit currency by the probable amount of 5,375,000*l.*

It is painful but necessary, to pursue the analysis. In March 1835, the treasure in the coffers of the Bank, was reduced from 10,200,000*l.*, its amount in December 1833, to 6,295,000*l.*, and, on all sound principles, the Bank directors ought to have reduced their issues from 17,469,000*l.*, their amount in December 1833, to 13,564,000*l.*, This would have effected a reduction in the circulating currency to the actual amount of 3,905,000*l.*, and a reduction in the credit currency, to the probable amount of 19,525,000*l.*, making a total reduction in the medium of exchange, of about 23,430,000*l.* But, in their systematic disregard of principle, the Bank directors increased their issue of Bank notes, from 17,469,000*l.* to 18,152,000*l.*, and thus added 683,000*l.* to the actual amount of the circulating currency, and 3,415,000*l.* to the probable amount of the credit currency; they caused a total expansion of the medium of exchange, to the amount of 4,098,000*l.*, under circumstances which, had the circulating currency been metallic, or had the issue of Bank paper been regulated on sound principles, would have

occasioned a contraction to the amount of 23,430,000*l*.

From the 23rd of August, to the 15th of November, 1836, the average amount of treasure held by the Bank of England was 4,933,000*l*., being less, by 5,267,000*l*., than the amount held in December 1833, while the amount of Bank of England notes in circulation, was increased to 17,543,000*l*., being more by 74,000*l*. than the amount of Bank of England notes in circulation in December 1833.

By the gazette account of the assets and liabilities of the Bank of England, from September 20th to December 13th of the present year, it appears that the average amount of treasure during the quarter, had declined to 4,545,000*l*., being less by 5,655,000*l*. than its amount in December 1833, and that the average amount of Bank of England notes in circulation during the quarter was 17,361,000*l*., being less by 108,000*l*., than the amount in circulation in December 1833. Thus, the directors of the Bank of England, after losing 5,655,000*l*. of their treasure—urging the Chancellor of the Exchequer to raise the rate of interest upon exchequer bills, because the currency was in excess—paralysing our export trade, by refusing American bills, in order to check exportation of gold to the United States

and spreading distrust and alarm throughout the country, until we approached the verge of a domestic panic, which threatened to destroy the whole superstructure of credit currency, and brought the Bank of England itself in danger of stopping payment — at length adopted the precaution of contracting their circulation to the amount of 108,000*l.*!!

*Insufficiency of the Defences set up for the Bank Directors.*

The advocates of the Bank of England bring forward a variety of statements, for the purpose of showing, that the directors cannot always conform to the principle of leaving their circulation to expand and contract under the action of the exchanges; and that if they were to conform to this principle, derangements in the money market would be occasioned, by the operations of other parties, for whose errors the Bank directors cannot be held responsible. The insufficiency of defences, resting upon such statements, I will endeavour to make manifest.

*1st.*—It may be urged in refutation of the charge of mis-management here brought against the Bank directors, that the foregoing calculations, respecting the extent to which their adherence to sound principles would

have contracted the medium of exchange, are overcharged, and extravagant in the highest degree; and that, on whatever principles the Bank directors might have acted, it would have been utterly impossible for them to have effected, between December 1833 and March 1836, a contraction of the medium of exchange to the enormous extent of 23,000,000*l.*; because, before a contraction approaching to this extent could have been effected, there would have been such a fall of prices, and such a decrease of imports and increase of exports, as must have turned the exchanges in our favour, and have caused an influx of the precious metals, requiring the issue of an increased amount of paper in exchange for the gold poured in upon the Bank.

This argument proves too much; and, by proving too much, serves, not to refute, but, on the contrary, to confirm the charge of mismanagement brought against the Bank. It is quite true, that, between December 1833 and March 1836, a contraction of the medium of exchange to the extent of 23,000,000*l.* could not by possibility have been effected; but then it is equally true, that had the Bank directors regulated their issues upon sound



principles, the circumstances indicating such a degree of contraction never could have arisen. If the directors had withdrawn their notes from circulation, as bullion was withdrawn from their coffers, it is probable that, before their treasure could have been reduced from 10,200,000*l.* to 8,000,000*l.*, the exchanges would have been turned in our favour. Had the first exportation of gold, to the amount of 2,000,000*l.*, been accompanied by a withdrawal of Bank of England notes to a like amount, the amount of the cash returning to the banks of deposit, at the close of each day's business, would have been reduced by 2,000,000*l.*, and this contraction of the circulating currency would have occasioned, in the manner already explained, a contraction of the credit currency, amounting, it is probable, to 10,000,000*l.* Thus there would have been a total contraction of the medium of exchange to the amount of 12,000,000*l.*, and it cannot be doubted but that this contraction would have been sufficient to have brought our currency to par with foreign currencies, and to have arrested the efflux of the precious metals. The considerable and long-continued drains to which the coffers of the Bank of England

have hitherto been liable, could never have occurred, had the Bank directors regulated their issues upon sound principles.

*2nd.*—It has been urged, in defence of the conduct of the directors of the Bank of England, that they have two separate and opposite functions to perform; namely, to regulate the currency, and to support commercial credit; that, in the performance of these opposite functions, it is found impossible to act upon the same uniform system; and that, in particular states of the money market, it becomes necessary to depart from general principles, and to avert a domestic panic, by issuing an increased amount of Bank paper, even during the continuance of an adverse exchange.

This defence of the Bank requires to be scrutinised. As the directors consider it to be a part of their duty to watch over, and sustain the commercial credit of the country, it becomes necessary to examine under what circumstances, and in what manner, they can be required to perform so important a function.

It is evident that the directors of the Bank of England can have no power to relieve any species of commercial pressure, except that which may be occasioned by a derangement of

the currency. The consumption; the spring number of our com- rivals; the deterioration effected, begins to errors in commercial as now find that danger tion; may each, and at quarter. The banks porary depression, or whether of deposit of trade, unconnected with pressure, and currency, and incapable of contracting their liabilities, banking operation. Now reserve of cash; in cial pressure, even when is shaken, gold is a contraction of the and sovereigns are held cannot, in the major the Bank of England; removed by any means, more sudden and more the province of the g. threatens to exhaust adopt. A convertible conform to the standard circumstances under represents. While say that the Bank should 3*l.* 17*s.* 10½*d.* per ounce function of sustaining standard of value, even When the directors have the value of gold, considerable extent, to draw contracting the current adverse exchange draws that pressure upon the establishment becomes a fall of prices. Now situate dangers; and they be raised in a variety one, without approaching the import duties, either not *contract* their issues, countries; by change exhausted by the con- tions of foreign state foreign exchange; and if relative superiority, as their issues, their coffers export, which entails the immediate action of a of the two dangers, that of

having their coffers emptied by domestic panic, is the most serious and the most pressing; and therefore, in an emergency leaving only a choice of evils, the Bank directors are justified in disregarding the principle of regulating their issues by the foreign exchanges, and in making such advances as may be necessary to restore commercial credit. But does the necessity under which the Bank directors are occasionally placed, of resorting to extraordinary measures for the purpose of mitigating a pressing mischief, afford a justification of the previous deviations from principle by which that mischief was created? Could a surgeon, who had wounded an artery, instead of having opened a vein, vindicate his professional reputation, by showing that he had secured the blood vessel before his patient bled to death? Could an incendiary escape condemnation, by proving that he had laboured at the engine by which the conflagration which he had kindled was at length subdued?

When, in 1826, the Bank directors restored commercial credit, by making extensive issues, regardless of the state of the foreign exchanges, their conduct received, as it deserved, the highest praise; but this conduct, however praiseworthy in itself, cannot be referred to,

of which the far greater number of commercial transactions are effected, will give way. The directors now approach from another quarter, throughout the kingdom, where, in the hour of issue, feel more or less, and become desirous of contracting, and of increasing their resources in proportion as confidence is shaken. Gold is preferred to paper, and sovereigns rather than the notes of the Bank, and a domestic drain, more serious than the foreign, threatens its coffers.

These are the only circumstances in which it can be necessary that the Bank exercise its vaunted function of maintaining commercial credit. When the Bank is neglected to any considerable extent in their notes as an advertisement, out their gold, their estate is exposed to two opposite dangers, and cannot avoid the one, or the other. If they do not issue their treasure may be diminished by the continual action of the foreign market, they do not *increase* the amount, may be emptied by the domestic panic. Of the

the money market, of England, those which the currency is laid upon to essential duty, the course of gold never be superfluous duty, of commercial inflict disease, to administer and lastly in the

has been occasioned, not by the action on the part of the directors of the Bank of England, but by the excessive amount of paper thrown into circulation by the provincial banks, and particularly by those which are formed on joint-stock principles. It is contended that the strictest application, on the part of the directors of the Bank of England, of the principle of allowing the amount of their issue to increase or diminish under the action of the foreign exchange, cannot have the effect of keeping the currency of this country from being redundant, in relation to the currency of other countries, while the paper of the provincial banks, issued without reference to the state of the exchanges, flows into the channels of circulation, as the paper of the Bank of England is withdrawn.

The plea thus set up for the Bank of England, demands serious consideration; and, if valid, it leads to a very important practical conclusion. If it be true, that the principle of leaving the circulation of the Bank of England to expand or contract, under the action of the foreign exchanges, can be rendered inoperative by the issuing of paper by provincial banks, then the necessary inference is, that no provincial banks of issue should be permitted to exist. If the issuing



in justification of the previous establishment of the circulation of the Bank of the currency by which the frightful panic of the same state is occasioned. In like manner, purely metallic, conduct of the present directors, conclusion, that liberal advances upon mere the exclusive and in affording assistance should be given banks, without waiting for a avowed. The precious metals, is laudable England contend, conduct, however calculated respect to the issuing serious crisis, cannot remain confined to the possibility they have incurred be extended to departure from principle.

the mitigated panic of the operations of the only disturbances in the tract, and render which the directors of trade by the Bank of have any power to correct currency at par with their own mismanagements not quite consistent creates. If they could do, that the directors attend with strictness, they are prevented from of regulating their issues according to the the foreign exchanges, necessity they are under called upon to perform credit. Were it of watching over and of the provincial banks credit. When they are of circulation as the they will no longer be England is withdrawn, remedies.

3rd.—We hear it influence of an adverse asserted, that the result would be no narrowing

tion, and no pressure  
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 England in support of  
 On the other hand, the  
 and so fatally experienced,  
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 principles, and to preserve the medium  
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 close to which it would be occasionally  
 were the circulation purely metallic.

25, the Bank of England narrowed its  
 s by upwards of 3,000,000%.; but the  
 incial banks, instead of being able to  
 nteract the operation, by increasing their  
 ues to a corresponding amount, were  
 ushed and extinguished under the cala-  
 mitous pressure which it occasioned. And,  
 in the present year, when the directors of the  
 Bank of England resorted to measures for  
 contracting the currency, the provincial  
 banks of issue, instead of being able to throw

increased supplies of paper into the channels of circulation, were crippled and paralysed, and compelled to resort to the Bank of England for assistance.

These facts afford experimental proof that, in the particular instances in which they occurred, the directors of the Bank of England had uncontrolled dominion over the circulation of the kingdom, and that when they decreed a contraction of the currency, the provincial banks of issue, instead of resisting, obeyed and suffered. But, upon a subject so important as that now under consideration, it would be neither satisfactory nor safe to rest our conclusions on these particular instances, however striking and decisive they may appear ; and I shall therefore proceed to demonstrate, by a reference to general facts and principles, that, if the issues of the Bank of England were regulated by the foreign exchanges, it would be impossible for the provincial banks to keep an excess of paper in circulation.

It will be evident that, if the circulating money within sixty miles of London were wholly metallic, no over-issue of paper, in places exterior to the metropolitan district, could occasion an extension of the currency within that district. In this case, no con-

ceivable increase in the amount of provincial paper could increase the amount of the circulating money of the metropolis; because, by the supposition, this circulating money consists exclusively of coin. But if the increase of provincial paper could not increase the circulating money of the metropolis, neither could it increase the credit money of the metropolis; because, if the metropolitan banks of discount and deposit did not obtain an increased amount of circulating money, to serve as their reserve, or rest, to meet increased occasional demands, they would not be able, with safety to themselves, to make increased advances to their customers; and if the customers of the banks did not obtain increased advances, they could not pay into the banks an increased amount of deposits. It is strictly demonstrable, that if gold was substituted for Bank of England notes in the London district, and if the London banks of deposit and discount were to preserve the due proportion between their reserves and their liabilities, no over-issue of paper, exterior to the London district, could increase the amount, either of the circulating money, or of the credit money, of which the currency of London would, in this case, be composed.

As an excessive issue of provincial paper

could not, if the circulating money of London were metallic, occasion a corresponding expansion in the London circulation, the necessary result of such excessive issue would be, that the currency of the provinces would be rendered redundant, in relation to the currency of the metropolis. Prices would rise in the country markets, without a corresponding rise of prices in the London markets; a greater quantity of goods would be sent from London to the provinces, and less quantity from the provinces to London; the balance of payments would be turned in favour of London, and against the provinces; and the merchants and dealers of the provinces, who had remittances to effect, would return the excess of paper upon the bank which had issued it, and demand bills upon London in exchange: and hence, to whatever extent the undue expansion of the provincial currency might have been carried, this certain and speedy process of contraction would restore it to par with the currency of London. While the circulating money of the metropolitan district continued to be exclusively metallic, an excessive issue of paper on the part of the provincial banks, could neither render the currency of London redundant, in relation to foreign currencies, nor, for any long period, render the provincial

redundant, in relation to the currency of London.

There is another important consideration connected with this branch of the subject. If the circulating money of London were wholly metallic, the currency of London would in all ordinary times, remain at par with the metallic currencies of foreign countries; and could never deviate from that par to a greater extent than that measured by the expense of remitting gold. Hence, when the currency of the provinces, in consequence of the over-issue of paper, became redundant, in relation to the currency of London, it would also become redundant in relation to foreign currencies. The merchants of the provinces would import a greater quantity of foreign goods, and export a less quantity of British goods; and, consequently, would have balances to remit to their foreign correspondents. Now, in order to effect these remittances, they would return provincial paper upon the banks which issued it, in exchange for bills upon London; and with these bills they would purchase foreign bills. This might have some effect upon the exchanges; the increased demand for foreign bills might raise their price, until it became profitable to export gold in order to draw against it; and this exportation of gold would occasion some



traction in the amount, and some rise in the value, of the London currency. This effect, however, could be only slight and temporary ; for the currency of London being previously at par with foreign currencies, a very moderate rise in its value would turn the exchanges in our favour, and bring it back to par. Upon the whole, an over-issue of paper, by the provincial banks, instead of increasing the volume, and reducing the value, of the London currency, would, though to a very slight extent, produce the directly opposite effect, of contracting its volume, and raising its value.

Let us now apply the conclusions at which we have arrived. That which would be true if the circulating money of the metropolis were exclusively metallic, would be equally true if the circulating money of the metropolis consisted exclusively of Bank of England paper, always maintained in the same state, both with respect to amount and to value, in which a purely metallic circulation would exist. Now, if the Bank directors were to regulate their issues by the foreign exchanges, the paper circulation of the metropolis would be exactly equal, both with respect to amount and value, to a metallic circulation ; and consequently, every excess of provincial paper would raise prices in the markets of the *provinces*, without raising them in the

markets of London ; would turn the balance of payments against the provinces ; cause the excess of provincial paper to be returned upon the banks of issue, in exchange for bills upon London ; and, by creating an increased demand for foreign bills, to pay the foreign debts incurred during the high range of provincial prices, would have a tendency to contract the currency of the metropolitan district, rather than to render it redundant. If the directors of the Bank of England were to regulate their issues upon sound principles, the over-issues of the provincial banks would be almost immediately returned upon them, and therefore could not, except for periods too brief to be important, have any sensible effect in increasing the amount, and reducing the value, of the general medium of exchange. While the Bank of England retains its exclusive privileges in the metropolitan district, no considerable or protracted derangement in the money market can take place, except in consequence of the failure of the directors to regulate their issues upon sound principles.

■ In the actual state of our monetary system, there is a disturbing circumstance, which it would be improper to overlook. The notes of the Bank of England circulate in the provinces to a considerable extent. Hence

were the provincial banks to issue to excess, the Bank of England notes thereby displaced, might be sent to London to pay the balances becoming due from the provinces in consequence of the high range of provincial prices. This would increase the circulating money of the metropolis, enable the London Bankers and bill brokers, to rediscount the bills endorsed by the provincial bankers, and thus occasion an increase of credit money throughout the country. But, for the existence of this disturbing cause, the directors of the Bank of England are exclusively responsible. They have established branches in the provinces; they have made contracts with Joint-Stock Banks for the purpose of inducing them to conduct their business with Bank of England paper, instead of becoming banks of issue; and they have prevailed upon the Legislature to make Bank of England notes a legal tender, so long as they are convertible into gold at the places where they are issued. All these measures are erroneous. The Bank of England should either supply the *whole* circulation of the provinces, or else should supply *no part of it*. While the directors adopt means for the supplying of a *part* of the provincial circulation, without being able to secure the supplying of the *whole*, they

must occasionally be liable to difficulties which they would not have to encounter, were they to limit their issues to the district over which their exclusive privilege extends.

*4th.*—It has been supposed that the connection which exists between the Government and the Bank of England, deprives the directors of the power of adhering with sufficient strictness to the cardinal and essential principle of regulating the amount of their issues by the course of the foreign exchanges. The Bank of England conducts all the monetary transactions of the Government. “It acts,” says Adam Smith, “not only as an ordinary bank, but as a great engine of state. It receives and pays the greater part of the annuities which are due to the creditors of the public; it circulates exchequer bills, and it advances to Government the annual amount of the land and malt taxes, which are frequently not paid till some years thereafter.”

Now, it will be found, upon a careful examination of the matter, that the compound character of the Bank of England, as thus described by Adam Smith, creates no real obstacle to the strict and uniform application of the principle of allowing the amount of its issues to expand and contract under the

were the provincial banks to. In order to re-  
the Bank of England notes difficulty and embar-  
might be sent to London to of this principle,  
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the Government business, if the Bank of England were not a bank of issue.

If the Bank of England were a bank of deposit and of discount, without being at the same time a bank of issue, the directors would conduct the business of the public on the same principles on which a private London banker conducts the business of a private merchant. In the first place, they would deal with public deposits in the same way in which private deposits are dealt with. When the sums paid in on account of the produce of the revenue exceeded the amount required to defray the occasional and periodical charges of Government, they would be employed as a private banker would employ them,—upon available securities bearing interest; and would be re-issued to the public in the purchase of exchequer bills, or of stock, or in the discount of mercantile bills. *This branch of the Government business would, therefore, be conducted without occasioning any contraction of the circulation.*

In the second place, if the Bank of England were a bank of deposit and of discount, without being, at the same time, a bank of issue, the directors, when required to make advances to Government, either for the periodical payments of the dividends, or for any



other purpose, would provide the necessary sums, on the same principles on which a private London banker would provide the means of making advances to his customers. They would realize the requisite amount of cash, by selling the stock and exchequer bills they had purchased with the Government deposits; by monies received in payment of bills discounted; and, if necessary, by resorting to their own capital. By these means, the sums required for effecting the Government payments would first be withdrawn from, and would then be immediately thrown back upon, the channels of circulation; *and therefore this branch of the Government business would be conducted without occasioning an expansion of the currency.*

While the Bank of England, in consequence of its being a bank of deposit and of discount, without being at the same time a bank of issue, would be thus enabled to hold balances for the Government, and to make advances to the Government, without contracting the currency in the one case, or extending it in the other, let us suppose a bank established in London, which is neither a bank of deposit, nor of discount, but simply a bank of issue. Let this bank possess, as the Bank of England now

possesses, the exclusive privilege of supplying the paper circulation of the metropolitan district ; but let it have neither branch banks, nor contracts with joint-stock banks, for pushing its notes into circulation in the provinces ; let it, when the exchanges are at par, keep one-third of its circulation upon securities bearing interest, and one-third upon the security of treasure in its coffers ; let it, when the exchanges become adverse, contract its circulation by selling gold ; and when the exchanges become favourable, extend its circulation by purchasing gold. In this case, the circulation of the metropolitan district would be liable to no greater fluctuations, either in amount or in value, than those to which a purely metallic circulation would be liable. As surely as water finds its level the currency of the provinces would conform to the currency of London ; there would be no periodical scarcity of money, and contrivances of accustomed accommodation, requiring occasional departures from principle, in order to support commercial credit ; and the transactions between the Government, and the bank conducting the Government business, could not, however great their magnitude, have any effect, either in contracting or in extending the general medium of exchange.

Let us make another

Instead of there being one bank of deposit and discount, for transacting the Government business, and another bank of issue, for supplying the circulation of the metropolis, let us suppose that the directors of the Bank of England form their establishment into two separate departments; the department of discount and deposit, and the department of issue. Let the committee of management entrusted with the department of discount and deposit, conduct the business of Government, and of individual customers, on the ordinary principles which are observed by London bankers, and independently of the department of issue; and let the committee of management presiding over the department of issue, keep their own securities at all times even, and allow the circulation to expand or contract under the action of the exchanges, without reference to the amount either of the securities, or of the balances, or of the advances, which the department of discount and deposit might hold or make. It is obvious, that if this principle of division of employment and separation of functions were adopted, and strictly acted upon, by the directors of the Bank of England, results identical with those described in the preceding paragraph would

necessarily ensue. The circulation, both of the metropolis, and of the provinces, would be maintained in the self-same state in which it would exist, were it exclusively metallic. Occurrences similar to that of the great panic of 1826, or even to that of the mitigated panic of the present year, would become impossible events.

With a view to the immediate Reform of our monetary system, the practical question for consideration is,—are there any insuperable difficulties opposed to the adoption, by the Bank of England, of the division of employment, and of the complete separation of functions above described? Some of the directors of that establishment are masters, not only of the practical details of the money market, but of the scientific principles of money and exchange. The opinions of these enlightened individuals, if known to be sanctioned by the approval of your Lordship, and of the Government, would probably prevail in the deliberations of the Bank parlour. But should the fact prove otherwise,—should a majority of the directors of the Bank of England obstinately refuse to introduce a proper division of employment into their establishment,—then the Legislature will be called upon to determine the question, whe-

ther the medium of exchange should continue to be entrusted to the management of twenty-four London merchants, qualified by being proprietors of Bank stock, elected by their co-proprietors, and having for their first object and primary duty, the protection, not of the public interests, but of their corporate property? Experience would scarcely suggest an affirmative decision of this question.

I shall briefly recapitulate, and conclude. The considerations which I have presented to your Lordship will, as I venture to believe, be found sufficient to establish the positions :—

That Bank deposits which may be drawn against as signs perform the functions of money, and are important parts of the general medium of exchanges :—

That a great amount of circulating money becomes the basis of a much larger amount of bank deposits, or credit money :—

That the recent disturbance in the money market was occasioned by the error committed by the directors of the Bank of England, in departing from the principle, of leaving the quantity of bank deposits to expand under the influence of the money exchanges :—

That the error originated in the failure of the Bank directors to distinguish between the bank deposits upon the general medium of exchange, and a diminution of their circu-

lation, and by a diminution of their deposits :—

That if the Bank of England were to regulate its issues of paper by the course of the foreign exchanges, the circulation would always remain in the same state, both with respect to amount and to value, in which it would exist were it wholly metallic ; and that no over-issue of paper by the provincial banks could have any permanent effect in rendering the currency of this country redundant in relation to the currencies of other countries :—

That the interposition of the Bank of England for the purpose of supporting commercial credit, is necessary in those instances only, in which a previous departure from sound principles by the Bank directors themselves, may have occasioned a sudden contraction of the currency, and have produced a crisis in the money market :—

That if the Bank directors were to adopt a judicious division of employment, in conducting the two-fold operations of the Bank, and to establish a complete separation between its functions as a bank of issue, and its functions as a bank of discount and deposit, no transactions, of whatever magnitude, between the Government and the Bank of England, could interfere with the strict and uniform application of the only sound principle upon which a paper circulation can be regulated ; namely,

that of leaving it to contract or expand, as the foreign exchanges become favourable or adverse :—

And that should there exist, under the present arrangements and circumstances of the Bank of England, any practical obstacle to the establishment of a complete separation between the business of issuing paper, and the business of holding deposits and making advances, it will become necessary for the Legislature to place the medium of exchange under the management of competent functionaries, appointed, not by the holders of Bank stock, but by Government; responsible, not to their co-proprietors, but to Parliament; and having for their first object and primary duty the protection, not of their own corporate property, but of the general interest of the nation.

Trusting that the great practical importance of the subjects which I have now attempted to illustrate, will be received as my apology for thus addressing myself to your Lordship, I have the honour to be,

My LORD,

Your Lordship's most obedient,

Most humble Servant,

R. TORRENS.



### NOTE to *Page 28.*

The rule adopted by the Bank directors, of keeping their securities even, and of leaving the whole of their liabilities to be acted upon by the foreign exchanges, would be conformable to principle, if the Bank of England were simply a bank of issue, and had no liabilities consisting of deposits. But, as the Bank of England is a bank of deposit, as well as a bank of issue, this vaunted rule is not only contrary to principle, but is impracticable. An example will make this palpable. If the circulating money of this country were so redundant, as to require a contraction to the amount of 1,000,000*l.*, in order to bring the currency to par with foreign currencies; and if the merchants, who, under the adverse exchange, had remittances in specie to effect, were to return upon the bank 1,000,000*l.* of its paper, in exchange for gold, to be exported; then the requisite contraction of the circulating money would be effected, and the adverse exchange would cease. But if the merchants, who had this amount of specie to remit, had deposits, and drawing accounts with the Bank, and if they were to draw out their deposits in gold, for exportation, then no contraction of the circulating money would be effected; the currency would remain in excess, and the exchanges would continue to be adverse. Let us suppose, that when the exchanges turn against us, the Bank has a reserve of bullion to the amount of 8,000,000*l.*; and that the merchants having foreign remittances to effect, have deposits and drawing accounts with the Bank to a similar amount. In this case, if the directors were to adhere to their rule of keeping their securities even, the process of drawing out deposits in gold, for exportation, might proceed until the coffers of the Bank were completely exhausted, without a single note being

